

ABC, IRS Meet to Address Contractor Burdens

For many Americans, the three most feared words in the English language are Internal Revenue Service (IRS). During the late 1990s, in an effort to change its public image, the agency began a transformation to run more like a 21st century business. As a result of that initiative, the IRS now offers a number of programs and tools to assist taxpayers in resolving contentious and industry-specific tax issues.

The Industry Issue Resolution (IIR) program is one such effort that addresses frequently disputed and burdensome tax issues that affect a significant number of business taxpayers by issuing legal and/or administrative guidance. The IRS recently selected two issues that affect many construction contractors that work on residential projects and perform infrastructure, paving, site development, concrete and other construction services.

In recent years, the IRS has been taking a more narrow view of the definition of a "home construction contract" (HCC). Richard Shavell, CPA, CCFP, who serves as the chair of Associated Builders and Contractors' (ABC) Tax Advisory Group, says, "This more narrow view has raised uncertainty with how certain subcontractors should be treated for tax purposes. Since 1988, subcontractors such as site developers and paving contractors working on the common areas of typical home developments have treated their activities as HCCs. Over the last few years, the IRS has been taking the position that only certain work in the proximity of the home lot qualifies, and the impact is an acceleration



of tax. The contractors under this evolving definition of an HCC would be precluded from using the more favorable completed contract method, which applies today. The result is more taxable income earlier than should be required."

In August 2005, the IRS announced the IIR program would address the definition of home construction contracts. Earlier this year ABC and the Construction Financial Management Association (CFMA) filed a request asking the IRS to consider this issue. The construction industry trade associations told the IRS that,

"The definition of home construction contracts is not currently sufficiently defined, and interpretations have been subject to debate. Guidance is needed regarding the meaning of home construction contracts as defined by IRC 460(e)(6)(A), primarily as it relates to 'improvements to real property directly related to such dwelling units and located on the site of such dwelling units' and 'common improvements' when the taxpayer is not also constructing the related dwelling unit."

On Dec. 14, 2005, the IRS and interested parties, including real estate developers, met to explain the industry's understanding of the issues and to help the IRS better understand industry practices.

Recently, an IRS representative indicated that two similarly situated subcontractors performing identical construction services on home developments could be treated differently solely because of the structure of the property owner.

Shavell, who participated in the meeting as a construction industry representative, says, "The industry expressed concern to the IRS about this intended policy and the resulting administrative burden on subcontractors that have to inquire as to how property owners are structured merely as a prerequisite of determining how the specific contract is to be reported for tax purposes. On behalf of the construction industry, we presented the view that the focus must be on the nature of the work performed and not based on ancillary information that may be difficult for a subcontractor to acquire. Getting to a conclusion so that two subcontractors performing the same work are treated similarly is part of the underlying purpose of the IIR process."

The IIR process has a timeline of nine months for achieving certain results, which may include recommending legislative or regulatory changes, issuing revenue rulings, or issuing no guidance. All interested parties are hopeful they can reach a compromise on this issue.

Nersesian is ABC's director of legislative affairs.